

VZCZCXRO8071
RR RUEHGH
DE RUEHHK #1925/01 2911154
ZNY CCCCC ZZH
R 171154Z OCT 08
FM AMCONSUL HONG KONG
TO RUEHC/SECSTATE WASHDC 6041
INFO RUEHBJ/AMEMBASSY BEIJING 2645
RUEHGP/AMEMBASSY SINGAPORE 3937
RUEHGZ/AMCONSUL GUANGZHOU 1427
RUEHGH/AMCONSUL SHANGHAI
RUEHIN/AIT TAIPEI 0073
RUEATRS/DEPT OF TREASURY WASHDC

C O N F I D E N T I A L SECTION 01 OF 03 HONG KONG 001925

SIPDIS

STATE FOR EAP/CM AND EEB/OMA; TREASURY FOR OASIA DOHNER AND
U/S MCCORMICK

E.O. 12958: DECL: 10/17/2033

TAGS: EFIN ECON HK

SUBJECT: HONG KONG GOVERNMENT PUSHES BANKS TO RESOLVE
LEHMAN MINIBOND CONTROVERSY

REF: HONG KONG 1757

Classified By: Acting Consul General Christopher J. Marut, Reasons 1.4
b/d

¶1. (C) Summary: Hong Kong government officials, in response to recurring public demonstrations by angry purchasers of Lehman "minibonds," have encouraged distributing commercial banks to buy back these structured debt instruments at some percentage of their face value. Many of the banks are reluctant to do so before realistic valuations can be determined, but face increasing official pressure to help the government resolve this political problem. Political parties in Hong Kong have jumped on the issue as they compete to prove who can best represent the rights of the downtrodden Hong Kong investor. End Summary.

¶2. (C) Comment: The plight of Lehman "minibond" purchasers has all of the elements the Hong Kong press loves: poor investors who bet their retirements on Lehman Bros. products; heartless bankers who misled elderly and unsophisticated purchasers to make a buck; hapless government officials who failed to protect consumers; and increasingly public government efforts at arm-twisting the banks into settling with angry customers. Hong Kong government regulators are investigating complaints of improper selling but these efforts will take some time. Regulators are under pressure from the Administration to quickly find a political way out of the storm. The minibond crisis illustrates the Hong Kong government's split personality: on one hand, officials consistently reaffirm their commitment to market principles and their faith in Hong Kong regulatory institutions. On the other, the unelected and poll-phobic government abandons its faith in regulatory procedures and pressures banks to pay up to help defuse a hot-button political issue. End Comment.

=====
Lehman Bankruptcy Hits Hong Kong Investors
=====

¶3. (C) Lehman Bros., bankruptcy has become a political problem in Hong Kong as investors in Lehman Bros.-issued "minibonds" (actually synthetic CDOs tied to price movements of selected international stocks and other assets) accuse banks of misinforming buyers of the risks and pressure the Hong Kong government to step in. An estimated 43,000 Hong Kong residents may have invested as much as US\$ 2.6 billion (HKD 20.17 billion) in Lehman Bros. products, which were primarily marketed by retail banks. HKMA officials say over 33,000 of these investors purchased US\$ 1.5 billion (HKD 11.25 billion) worth of minibonds. Retail investors have organized to demonstrate in front of banks and are working

with Hong Kong political parties to demand full compensation.
(Reftel)

¶14. (U) HKMA is working to investigate over 9,000 complaints of improper selling by banks, many collected and forwarded by Hong Kong political parties eager to stake out territory as protectors of the people. HKMA's Banking Policy division has reassigned one-third of its staff and hired external contractors from Hong Kong accounting firms to help process complaints. Hong Kong regulations require financial intermediaries selling investment products, including both banks and securities firms, to accurately explain products and the risks they entail. HKMA has issued guidance to banks (March 2006) advising them to take special care when explaining investment products to the elderly.

===== ==
HKMA Assesses Complaints, Tries to Value Assets
===== ==

¶15. (C) HKMA Executive Director Arthur Yuen rejected allegations that HKMA and SFC had failed to provide proper supervision of financial intermediaries. While some cases of improper selling undoubtedly exist, most complaints are politically driven efforts to recoup losses on risky investments, he said. HKMA has responsibility to ensure that banks have proper internal controls to make improper selling difficult and to meet out discipline if investigations find evidence of inappropriate activity. Yuan offered that investigations are likely to take at least several months. Adjudicators are first determining whether filed complaints

HONG KONG 00001925 002 OF 003

appear to have merit. He estimated 20-25 percent will be dismissed for not showing sufficient cause to warrant additional investigation. Of the remainder, the vast majority will also prove baseless, he said. Those banks that are found to have misled or misinformed investors will face fines and other disciplinary measures.

¶16. (U) The HKMA has been working with the Secretary for Financial Services and the Treasury to urge banks and the minibond trustees (HSBC is the major trustee) to value the minibonds' underlying assets. While Lehman Bros. is bankrupt, the assets behind the minibonds are still worth something. Banks have been reluctant to try to value these assets because their worth depends on market prices and liquidity. In the current market, immediate sale would result in severely limited recovery. A more protracted unwinding could improve the ultimate value and result in additional funds to return to investors.

¶17. (C) Undersecretary for Finance and Treasury Julia Leung estimated that 10 percent of minibonds will ultimately prove worthless, while 80 percent of the minibonds will return 60 to 70 percent of their face value. These estimates have been roundly criticized by banks, who argue it is impossible to properly value the underlying assets in the current market. Investors have seized on these numbers, which have become a floor in their demands for bank compensation.

===== ==
HK Pols Show Compassion while HKG Pressures Banks
===== ==

¶18. (U) Investors have been regularly staging media-intensive demonstrations at Hong Kong government offices, HKMA, LegCo and banks, with the help of Hong Kong political parties. The Democratic Party was first to seize on the issue, followed quickly by the pro-Beijing Democratic Alliance for the Betterment of Hong Kong (DAB) and Civic Party. Party leaders from all three have advised and accompanied investors to meetings with bank officials to demand compensation. Mirroring the government's unspecified grounds to force a buy-back on bankers, the politicians are making moral rather than regulatory appeals for justice, albeit with increasing

caution as evidence of actual regulatory violations has yet to surface. Hundreds of protesters took to the streets on the weekends following Lehman's collapse. While the number of protesters has fallen in recent days, the intensity has increased, with demonstrators scuffling with police on October 8, as they demanded full compensation from the banks.

¶9. (U) On October 6, Financial Secretary John Tsang, HKMA Chief Executive Joseph Yam, and Secretary for Financial Services and the Treasury invited distributing banks and brokerages to discuss ways to help investors. The government proposed that banks repurchase the minibonds at current market value and return the funds to investors and reportedly gave them one week to develop a common valuation model and buy-back plan. Chief Executive Donald Tsang urged banks to quickly take up the proposal.

=====
Banks Offer to Pay if Guilty of Mis-selling
=====

¶10. (U) HKMA's Yam and SFC Chairman Martin Wheatley appeared in the Legislative Council on October 13 to answer questions regarding regulator oversight of banks and securities firms engaged in selling Lehman Bros. products. They rejected charges that they had failed to properly monitor banks selling high-risk products, and put the onus back on the banks. "If banks followed all the SFC and HKMA regulations, investors would have sufficient understanding of the risk. The problem is whether banks followed all the regulations," said Yam. He urged banks found to have misled investors to offer compensation. Several banks have publicly agreed to do just that, if they are found to have misinformed clients. DBS, Citibank and Citic Kawah have all announced they will pay if their staff misrepresented products to consumers.

¶11. (U) The Chairman of the Hong Kong Association of Banks, He Guangbei, told the press October 10 that banks in Hong Kong are willing to work on the government's proposal to

HONG KONG 00001925 003 OF 003

compensate investors who have lost money. He offered that association members hoped to quickly appoint a financial advisor to help to value the assets underlying the minibonds and to set up a compensation package. But Chief Executive Tsang, in response to questions following his annual Policy Address to LegCo on October 15, said the banks need to move faster. He noted that the government's one week deadline for banks to announce their compensation plan had passed and demanded they reply by the end of the week. In addition, Tsang promised that the government would support a fund for citizens to pursue joint lawsuits against banks found to have violated Hong Kong regulations.

MARUT